ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review For Local Exchange Carriers	)	CC Docket No. 94-1,
	)	
Consumer Federation of America, International Communications Association and National Retail Federation Petition Requesting Amendment of the Commission's Rules Regarding Access Charge Reform and And Price Cap Performance Review for Local Exchange Carriers	)	RM-9210

REPLY COMMENTS

OF

THE CONSUMER FEDERATION OF AMERICA

THE INTERNATIONAL COMMUNICATIONS ASSOCIATION

AND THE

NATIONAL RETAIL FEDERATION

ON

NOTICE TO REFRESH THE RECORD

November 9. 1998

THE COMMISSION MUST LOWER ACCESS CHARGES TO MOVE THEM TOWARD COSTS, ELIMINATE EXCESS PROFITS AND PROVIDE CONSUMERS RATE REDUCTIONS

If local markets had been irreversibly opened a year ago and on their way toward effective competition, the Consumer Federation of America (CFA), the International Communications Association (ICA) and the National Retail Federation (NRF) would not have petitioned the Federal Communications Commission to reconsider its market-based approach to reducing access costs. It was clear then, however, after a series of legal and regulatory battles, that local markets simply would not develop sufficient competition to deliver the rate reductions that are necessary to drive access charges to cost in a time frame consistent with the Commission's intentions. Consumers were destined to pay excessive charges and incumbent local exchange carriers were certain to continue to earn excessive profits because there was no serious prospect that market forces could reduce meaningfully access charges.

Almost a year later, nothing has changed. The failure of local competition to develop and the continuing rise in excess profits earned in the interstate jurisdiction make it all the more critical for the Commission to immediately prescribe reductions in access charges and to ensure that they are passed through to ratepayers.

Proof of the failure of meaningful local competition to develop is overwhelming. The Commission has been presented with a mountain of evidence in the refreshed record that the exchange access market is not competitive and cannot be expected to become effectively competitive any time soon. The evidence of the failure of competition is clear in the structure, conduct and performance of the market.

Structure

- Incumbents continue to hold a 99 percent market share of facilities-based competition, which is the only form of competition that matters for access charges.

- Not one company has been found to meet the conditions for market opening under section 271 of the Telecommunications Act of 1996.

Conduct

- The incumbent local exchange companies (ILECs) continue their pattern of anticompetitive, market foreclosing behavior.

- Disputes over the implementation of market opening requirements promise to drag on into the foreseeable future.

Performance

- Incumbent exchange access providers continue to earn excessive profits, exceeding the target set by the Commission by a wide margin.

- Incumbents continue to price right at the cap in almost all cases. This demonstrates that they have adequate market power to preserve their excess profits, rather then being faced with competition that forces them to avail themselves of the downward pricing flexibility already allowed to prevent loss of market share.

Confronted with this overwhelming evidence that it cannot rely on the glacially slow development of market forces to reform pricing in the exchange access market, the Commission must act prescriptively to set exchange access on a rapid course to cost-based levels. Only by represcribing access charges can the Commission deliver rate relief to residential and business consumers, as Congress promised in the Telecommunications Act of 1996. The remainder of these comments will briefly review the overwhelming evidence before the Commission.

EXCHANGE ACCESS MARKET STRUCTURE

MARKET SHARE

The central fact before the Commission in assessing the market structure of the exchange access market is unequivocal. Nearly three years after the passage of the 96 Act, incumbent local exchange companies continue to possess a near total monopoly. Table 1 presents two estimates presented to the Commission in the record and adds a third recently published analysis of local competition.

Across the nation, incumbents retain a 97 to 98 percent market share. Even this extremely high market share understates the total dominance of the incumbents. These figures include total service resale. As a general proposition resale cannot be considered to contribute to effective competition as a market disciplining force because competitors utilizing resale are wholly dependent on incumbents. The ability of pure resellers to compete on price is completely constrained by the resale discount. With respect to exchange access, resale is totally irrelevant. Because incumbents retain access revenues on resold services, competition through resale cannot discipline market power in the exchange access market in any way.

Facilities-based competition, which is the only form that can be considered relevant in the exchange access market, is virtually nonexistent. On a national basis, far less than one percent of all lines have been captured by competitor facilities. In most cases facilities-based competition accounts for a few tenths of one percent of the local market.

TABLE 1:
INCUMBENT MARKET SHARE

	RBOC ONLY	MAJOR LECS BY AREA	MAJOR LECS BY COMPANY	
			ALL	FACILITIES BASED
AMERITECH	98.7	98.0	97.0	99.7
BELL ATLANTIC	98.4	99.4	99.2	99.3
BELLSOUTH	98.2	98.3	98.1	99.8
SBC	98.6	97.5	98.3	99.9
USWEST	98.2	99.0	98.4	99.9
GTE	NA		99.7	99.9
SPRINT	NA		99.8	99.9
TOTAL	98.5	98.6	98.7	99.8

SOURCES
RBOC ONLY= "MCI Worldcom, Inc. Comments," FEDERAL COMMUNICATIONS COMMISSION, In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Consumer Federation of America, Petition for Rulemaking, CC Docket No. 96-262 94-1, RM-9210, October 26, 1998, p. 9.
MAJOR LEC BY AREA= Robin Gareiss, "Brave New World Betrayed," DATA COMMUNICATIONS MAGAZINE, October 1998
MAJOR LEC BY COMPANY =
"Comments of the Ad Hoc Telecommunications Users Committee, FEDERAL COMMUNICATIONS COMMISSION, In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Consumer Federation of America, Petition for Rulemaking, CC Docket No. 96-262 94-1, RM-9210, October 26, 1998, Appendix 1.

BARRIERS TO ENTRY

The persistence of the exchange access monopoly stems from one simple source – the barriers to entry that the incumbents have erected and defended. Table 2 presents the results of the most recent assessment of the status of market opening for each of the companies that have pressed their applications for entry into interLATA markets. Almost three years after the passage of the 96 Act and over two years after the Local Competition Order, the complete failure of market opening is stunning. Not one company has even come close to meeting the standards in the Act.

At best, we find companies have met half of the 14 point checklist items. Moreover, the most important technical conditions have not been met. Operating support systems simply have not produced the non-discriminatory treatment of competitors that is necessary to allow local competition to grow. Incumbents refuse to accept the performance standards and performance penalties that the Department of Justice has identified as necessary to ensure non-discrimination on an ongoing basis. Incumbents have not complied with the spirit or the letter of the section 272, affiliate transaction rules.

Because the fundamental conditions to open local markets have not been laid, the possibility that companies could meet the public interest test is nil. Because the market opening conditions are not in place, effective competition is nowhere in sight.

TABLE 2:
STATUS OF COMPETITION IN RECENT 271 APPLICATION EVALUATIONS

COMPANY	SBC		AMER	BELL SOUTH		BELL ATLANTIC	
STATE	CA	TX	MI	GA	LA	NY	NJ
SOURCE	PUC		FCC	PSC	FCC	PSC	BPU
GENERAL ISSUES							
PUBLIC INTEREST	?	N	?	?	?	?	?
OSS	N	N	N	N	N	N	N
PERFORMANCE STANDARDS	N	N	N	N	N	Y	
PENALTIES	N	N	N	?	?	Y	
COLLOCATION	N	N	N	?	N	N	
TRACK A	?	N	N	N	N		
TRACK B	NA	NA	NA	NA	NA		
AFFILIATE TRANSACTIONS	N	N	N	?	N	Y	
CHECK LIST ITEMS							
1 INTERCONNECTION	N	N	N	Y	N	N	
2 UNE	N	N	N	N	N	N	N
3 ROW	Y	N	Y	?	Y		N
4 LOOPS	N	N	N	N	N	N	
5 TRANSPORT	N	N	N	Y	N		
6 SWITCHING	N	N	N	Y	N	N	
7 "911	N	N	Y	Y	?	N	N
8 WHITE PAGES	N	N	Y	Y	Y		
9 NUMBERING	Y	Y	Y	?	Y		
10 DATABASE	N	Y	Y	?	Y		
11 PORTABILITY	N	N	N	Y	N		N
12 DIALING	Y	N	Y	Y	Y		
13 RECIPROCAL COMP	Y	N	N	?	Y	N	N
14 RESALE	N	N	N	N	N	N	

SOURCES AND NOTES:
"Y"=in compliance; "N"=not in compliance; "?"=Commission took up issue, but reached no conclusion; " " = Not addressed

CA="Pacific Bell (U 1001 C) and Pacific Bell Communications Notice of Intent to file Section 271 Application for InterLATA Authority in California," CALIFORNIA PUBLIC UTILITIES COMMISSION, Final Staff Report, October 5, 1998
GA = "In Re: BellSouth Telecommunications Entry into InterLATA Services Pursuant to Section 271 of the Telecommuncations Act of 1996, GEORGIA PUBLIC SERVICE COMMISSION, Docket No. 6863-U, October 15, 1998
LA="In the Matter of Application of Bell South Corporation, Bellsouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services, Memorandum and Order, FEDERAL COMMUNICATIONS COMMISSION, CC Docket No. 98-121, October 13, 1998
MI= AMERITECH'S VIEW OF THE ROAD MAP, September 3, 1998.
NJ="Status of Local Telephone Competition: Report and Action Plan," BOARD OF PUBLIC UTILITIES, Docket No. TX96010010, July 1998
NY = "Petition of New York Telephone for Approval of its Statement of Generally Available Terms and Conditions (252) and Draft Filing of Petition for InterLATA Entry (271), Case 97-C-0271, STATE OF NEW YORK, Ruling Concerning the States of the Record, July 8, 1997; Prefiling Statement, April 6, 1998.
TX= "Investigation of Southwestern Bell Telephone Company's Entry into the Texas InterLATA Telecommunications Telecommunications Market, PUBLIC UTILITY COMMISSION OF TEXAS, Project No. 16251, June 10, 1998

INCUMBENT PROPOSALS

The track record of failure to convince the Commission, the Department of Justice or responsible state commissions that markets have been opened completely undercuts the claims of the incumbents that entry is easy and competition is robust. Competitors have been willing to beat on the regulatory walls and they have deployed assets to try to crack local markets, but, so far, the defenses erected by the ILECs have just been too stiff to overcome. Judging by the large number of conditions that have not been met, the battle to create meaningful levels of local competition looks a lot more like the trench warfare of World War I than the jet age combat of Desert Storm.

Incumbent suggestions that the Commission rely on partial fulfillment of the section 271 requirements to reduce regulatory oversight would simply expand the ability for unregulated market power to be abused. In fact, the USTA proposal would have the Commission believe that when the Track A requirement in section 271 is met, incumbents should be given significant pricing flexibility. USTA would have the Commission ignore the other twenty conditions that its members have failed to meet. Congress understood that these are the mere technical preconditions for, not the equivalent of, effective competition, but USTA proposes that pricing power be unleashed with partial fulfillment of one condition.

Section 271 is a legislative compromise on market opening, not a regulatory analysis of effective competition. In access charge reform, the Commission's standard should be effective competition, not just market opening. The Commission must reject proposals that would remove regulation before there is effective competition, since such proposals would inevitably allow incumbents to exercise their market power with impunity.

At a minimum, the Commission cannot allow pricing flexibility based on the technical compliance with one of the many conditions laid down by Congress for market opening. Rather, the Commission should make it clear that additional pricing flexibility will require full and sustained compliance with sections 251, 252, 253, 271 and 272 of the Act. For example, the Commission could adopt the type of pricing flexibility proposed in USTA Phase I only after a company has been authorized to sell interLATA service within a state for a year. It would allow that pricing flexibility for specific product/geographic markets – specific types of services provided to specific customer classes within a specific LATA – in which the equivalent of the Track A requirements have been met. A fully developed section 271 application should contain such information.

The Commission need not specify further flexibility at this time, since even that phase is far off. It is clear, however, that the criteria USTA proposes – the presence of a single competitor available to one-quarter of all customers – is unacceptable. Under this standard, there need be almost no actual competition and three quarters of the customers would have immediate prospect of competition. The Commission cannot conclude that such a situation would discipline the market power of the incumbent who could retain a near total monopoly. Before the Commission grants pricing flexibility that significantly reduced price cap discipline (e.g. Phases II and III of the USTA plan), meaningful levels of competition must be present. We can deal with that after Section 271 has been met.

INCUMBENT CONDUCT

The failure of local competition to develop and the failure to meet the section 271 conditions rest atop a broad and pervasive pattern of anticompetitive conduct. Local competition is not happening because the incumbents will not let it.

SECTION 271 BEHAVIOR

Table 3 identifies about fifty issues that demonstrate this pattern of behavior on the part of SBC. These include

- Violation of court rulings, contract terms and commission orders;
- Failure to make services available on a permanent basis at cost-based rates;
- Failure to make the 14 points on the competitive checklist available at nondiscriminatory rates, terms and conditions;
- Failure to provide OSS at parity;
- Performance measurement proposals that cannot ensure parity;
- Failure to institute the required safeguards for its long distance affiliate;
- Engaging in anti-competitive marketing practices in the local market.

The Commissions in California and Texas have recently found SBC to be grossly deficient in its implementation of the Telecommunications Act of 1996. The Texas and California Commissions found that SBC had failed to meet all but a few of the 14 points on the checklist. Texas found that SBC was uncooperative and made 129 recommendations for SBC and opened a collaborative process. SBC is not the only company engaging in these tactics, as the pervasive failure of section 271 compliance indicates.

TABLE 3:
SPECIFIC AREAS WHERE SBC FAILS TO MEET
REQUIREMENTS FOR ENTRY INTO IN REGION LONG DISTANCE

NON-COMPLIANCE PROBLEMS	CHECK LIST ITEM	SPECIFIC ACTS AND POLICIES	CITATION STATE/WITNESS
VIOLATION OF COURT RULINGS, CONTRACT TERMS AND COMMISSION ORDERS	ii	Failure to provide non-facilities-based recombination	ALL
	ii	Refusal to provide recombined elements as agreed	ALL
	ii	Refusal to file a collocation tariff as ordered	TX Was
	ii	Refusal to charge an agreed upon per order charge	TX Bur
	xiii	Refusal to pay reciprocal compensation for ISP traffic	ALL
	Xiii	Refusal to negotiate reciprocal compensation	CAL Brk
	Xiv	Refusal to make individual contracts available for resale	OK Whi
FINAL-COST BASED RATES ARE NOT IN EFFECT	i, ii	Rates are interim	CAL OK
	ii	UNEs, subject to court challenge	ALL
	ii	Non-recurring charges are not cost-based	ALL
	ii	Network element prices are not cost-based	ALL
	xiii	Reciprocal compensation subject to court challenge	TX
	xiv	Resale discounts subject to court challenge	TX
COLLOCATION DISCRIMINATION	ii	Excessive charges	ALL
	ii	Discriminatory ownership conditions	TX Lan
	Ii	Discriminatory operating conditions	TX Was
	ii	Failure to define collocation procedures	All
	ii	Failure to document lack of space	CAL ALL
FAILURE TO PROVIDE 14 POINTS ON CONDITIONS THAT ARE NOT DISCRIMINATORY	i	Interconnection: refusal to allow combined use of facilities	TX F/K
	i	Failure to load codes	ALL
	i	Refusal to provide NNI	ALL TCG
	i	Refusal to provide calling area information	TX Pel
	i	Failure to meet standards	CAL ALL
	Ii	Refusal to treat UNE/facilities-based entrants in a non-discriminatory	ALL Far, NEXT SPRNT
	ii	RTU claims and procedures are discriminatory	TX OK W
	ii	Refusal to provide digital loops	ALL
	iii	Discriminatory access to ROW, etc.	CAL ALL
	v	Refusal to provide dedicated transport	TX OK Ma, Kal
	v	Failure to demonstrate routing of calls	ALL
	vi	Refusal to provide intraLATA access as part of UNE use	TX F/K
	vi	Refusal to provide customized routing	TX OK Ma
	vii	Discriminatory 911, DA, OS	TX OK Ma, Hug
	viii	Discriminatory white pages	ALL
	ix	Discriminatory number administration	ALL

	x	Refusal to provide Access	CAL
		TCG	
	xi	Discriminatory number portability	ALL
	xii	Failure to demonstrate intraLATA dialing parity	ALL
	xiii	Refusal to treat CLEC as other ILECs are treated with the imposition of toll charges	TX OK G BUR Was
	xiii	Discriminatory Compensation	CAL MCI
	xiv	Discriminatory resale	ALL
	xiv	Change authorization is discriminatory	CAL TX MCI LAN
OSS PERFORMANCE IS NOT AT PARITY	all	Multiple entry ,	}ALL
		Incomplete editing capability,	}
		Manual processing especially for UNEs, Complex Orders,	}
		Error rectification by fax,	}
		Customer Service Records by mail,	}
		Information verification by telephone,	}
		Billing information incomplete	}
		Incomplete verification	}
		FOC delay	}
		Service interruption	}
	all	inability of OSS to perform at full commercial availability	ALL
PERFORMANCE P MEASURE Wes DEFICIENCIES	all	Refusal to provide individual measures for each CLEC	TX OK
		Refusal to provide measures of SWBT subsidiary	TX OK
		Failure to meet parity for even a restricted set of reported measures	ALL
		Lack of penalties	TX OK
		Failure to provide adequate measures	ALL
		Failure to provide measures for different categories of services	TX OK
ABUSE OF AFFILIATE MCI CR RELATIONS Bur	n/a	Failure to establish a 272 affiliate	ALL
		Refusal to report performance measures for affiliate	
		Delivery of internal OSS to pay-phone affiliate.	TX OK
ANTI-COMPETITIVE MARKETING	n/a	Penalties for customer contract termination	OK Cad
		Abuse of switching customers	Mc, Cad
		Win-Back Program	CAL LCI
		Abuse of CPNI	CAL SPRNT

SOURCES AND NOTES:

Underlined entries do not constitute disputes, rather they are Aofficial≅ positions of Southwestern Bell Telephone Company which violate the Telecommunications Act of 1996 as interpreted by the Department

of Justice and the Federal Communications Commission and clearly provide grounds for denial of the application for entry into in-region long distance

Non-underlined entries represent disputes that are of sufficient importance and documentation that, if left unresolved, would provide grounds for denial of the application for entry into in-region long distance.

The designation ALL, means that the issue has arisen in California and at least one other SBC state and has been raised by at least three companies.

Otherwise, the citations are as follows with companies and witnesses identified for Texas and Oklahoma and companies only identified for California (based on responses to Commission questions).

LEGEND FOR CITATIONS

OKLAHOMA AND TEXAS

AT&T – B=BARNES, C= CONNELLY, CR= CROMBIE, D= DALTON, F= FLAPPAN, F/K = FALCONE AND KRABILL, G= GADDY, L= LANCASTER, P=PFAU, T= TURNER, W= WICHTER,

MCI -- BA= BAROS, MA= MARTINEZ,

ACSI – KAL=KALLENBACH,

SPRINT -- STA=STAHLY, WES=WESTCOTT

TEXAS ONLY

DIG – DIGITAL NETWORK SERVICES

TCG -- FAR= FAROUH, MOU=MOUNT-CAMPBELL, PEL= PELLETEIR, WAS=WASHINGTON

TEXALTEL – BET=BETHANCOURT, BUC= BUCKLEY, LAN= LAND

TISPA KIS

USLD -- BAL= BALDWIN, BUR = BURKE

WESTTEL ROW

OKLAHOMA ONLY

ACSI – WHI= WHITE

BROOKS -- CAD= CADIEUX, HUG=HUGMAN

WESTERN – NEW= NEWSOME

CALIFORNIA

The company names are used.

Another area where the difficulty of opening markets has been demonstrated is the advanced services market. This is a market populated with sophisticated customers and service suppliers. Recent comments filed in the Section 706 proceeding attest to a pervasive pattern of anticompetitive tactics, with US West and Ameritech singled out for particular attention. Table 4 identifies over a dozen specific practices that have been identified.

TABLE 4:
ANTI-COMPSTITIVE CONDUCT IN THE HIGH SPEED DATA MARKET

BARRIERS TO ENTRY

- Denial/Delay Of Service
  - Denial Of Wholesale
  - Affiliate Preference
- Abusive Marketing
  - Steering
  - Slamming
- Information Abuse
  - Network
  - Customer
- Bundling/Tying
- Discriminatory Interconnection
  - Cross Connect
  - Degradation Of Service

ABUSE OF AFFILIATE RELATIONS

- Board Of Directors Not Independent
- Logo Exploited Unfairly
- Asset Transfer May Be Anticompetitive
- Byzantine Relations Make Oversight Impossible
- Price Squeeze
- Joint Marketing Abuse
- Cross Subsidy/Loop Cost Shifting

PROSPECTS FOR IMPROVING CONDUCT

The companies have also made it clear that they are not going to make it any easier to take down barriers to entry any time soon. Examples can be found in each of the companies. Bell Atlantic, which received a great deal of attention with its prefiling statement in New York, not only dragged its feet in New York, immediately repudiated those commitments in Pennsylvania.

SBC thumbed its nose at the collaborative process in Texas. After the Commission made 129 recommendations, SBC simply told the Commission to take the most important points off the table. Since it asserted that it was not legally bound to do what the Commission recommended, there is was no point in even talking about these matters. Needless to say, these were the most important recommendations and the most significant barriers to competition. As the Texas Office of Public Utility Counsel ("Comments of the Texas Office of Public Utility Counsel in Reply to Southwestern Bell Telephone Company's Initial Filing in the Collaborative Process," *Investigation of Southwestern Bell Telephone Company's Entry Into the interLATA Telecommunications Market*, Before the Public Utility Commission of Texas, Project No. 16251, June 21, 1998) put it before the Texas Commission,

> The Texas Office of Public Utility Counsel (OPC) commends the Commission for writing a well-reasoned recommendation in Southwestern Bell Telephone Company's section 271 proceeding that will promote competition and protect the public interest. That order identifies 129 steps that SWBT must take in order to open its local market. The order proposes a collaborative process to deal with difficult problems that have been unresolved for over two years. After solutions are worked out, SWBT implements them effectively and permanently, and gives competition a chance to take hold in Texas, OPC believes that the Commission, the Department of Justice (DOJ) and the Federal

> Communications Commission (FCC) will be able to find that the local market has been irreversibly opened to competition.
>
> Unfortunately, this is not what SWBT plans to do. It still has not gotten the message. It has refused to implement about 10 percent of the recommendations of the Commission and it has tried to take 75 percent of the recommendations off the table by deciding by fiat what it will do. In its opinion, only about one out of eight of the Commission's recommendations is the proper substance of a collaborative.

Developments in California have taken a similar tack. Recent reports in both collaboratives show that SBC is far from having open markets and far from willing to facilitate market opening.

Ameritech has said much the same thing. Wherever it disagrees with the Commission or the state PUC, it insists that regulators will have to reconsider their position. Almost three years after the Act, and after five applications have been denied, Ameritech (*Section 271 Status Report Ameritech's View of the "Roadmap"*, September 3, 1998) is still debating the framework, asserting the FCC is wrong in its interpretation declaring that

> [A] number of competitive checklist items still require Commission clarification or reconsideration. These include: the meaning of "nondiscriminatory" access to OSS, pricing of checklist items, unbundled local transport, unbundled local switching and combination of network elements (p. 7).

The points Ameritech disputes are not based on a lack of clarity but derive from Ameritech's rejection of the FCC interpretation. It admonishes the Commission and indicates it will not comply or continues to contest the Commission's point of view.

> Facilities-based competition: "There appear to be only two remaining issues: what constitutes "predominant" and whether PCS service is "telephone exchange service." In contrast, Ameritech disagrees with the Commission" existing legal interpretations regarding the availability of Track B" (p. 4).

> Operational Support Systems: "Finally, as the Commission has requested, Ameritech will provide updated evidence regarding manual and electronic OSS capacities. However, Ameritech is concerned that the Commission has been far too negative regarding business decisions to use manual processing for certain services or processes" (p. 8).
>
> Performance Standards: "As a result of the Commission's Order, Ameritech is evaluating additional potential performance measurements. However, Ameritech is concerned that the Commission has shown little regard for the practical consequences of adding additional performance measurements, in particular, those measurements that did not exist or were not previously used for Ameritech's retail operations" (pp. 8-9).
>
> Unbundled Local Switching: "This position is operationally incorrect, prohibitively expensive to implement and inconsistent with the Commission's own procompetitive rules and policies. If the Commission reconsiders this narrow issue, significant price arbitrage and extensive network recording costs would be eliminated, and there would be no need to develop the 'factor-based' approach discussed above" (p. 11).

Where it disagrees with the Court, it withholds the ordered services and appeals

> Because the Court's August 10 decision appears to overlook this undisputed fact and, as a result, is inconsistent with *Iowa Utilities Board*, Ameritech will file a petition for rehearing (p. 10).

It notes that the several key legal issues are unresolved, including combination of network platforms, shared transport and reciprocal compensation. Even if it should lose the subsequent court case, Ameritech indicates competition will not soon follow. It threatens and intends to force a reconsideration of any decision it loses in court.

> In the event the August 10 opinion is not modified, it is not obvious to Ameritech how it would be possible or technologically feasible to provide "shared transport" unbundled from switching (i.e. physically separated in a manner that allows a requesting carrier to combine). As the Commission seems to agree, such unbundling would result in service disruptions. If the August 10 Order becomes final, the definitional issues regarding dedicated

> trunks and interconnection trunks identified by Ameritech will also need to be resolved (pp. 10-11).
>
> The provision of existing, preassembled combinations of network elements, including so-called UNE platform, at cost-based rates is no longer required... Ameritech will be guided by the Commission's discussion in its South Carolina 271 Order. However, this area contains many unanswered questions and policy determinations, which need to be worked through (p. 11).

It is also abundantly clear that the public Interest Standard remains a bone of contention between the Commission and the Regional Bell Operating Companies.

> Ameritech is concerned with some of the specific "illustrative" factors described in the Michigan Order. Clearly, the public interest standard should not be used to create new and changing hurdles or requirements; nor should the already complex 271 process be converted into an omnibus complaint Docket, overriding standard State Commission or FCC forums and procedures. Rather, the focus of the public interest inquiry should be on the benefits customers will be afforded when a Section 271 application is granted (p. 12).

Given the willingness, demonstrated ability and clearly stated intention of the incumbents to prevent competition in local markets, the FCC cannot rely on competition to reduce access charges any time soon.

MARKET PERFORMANCE

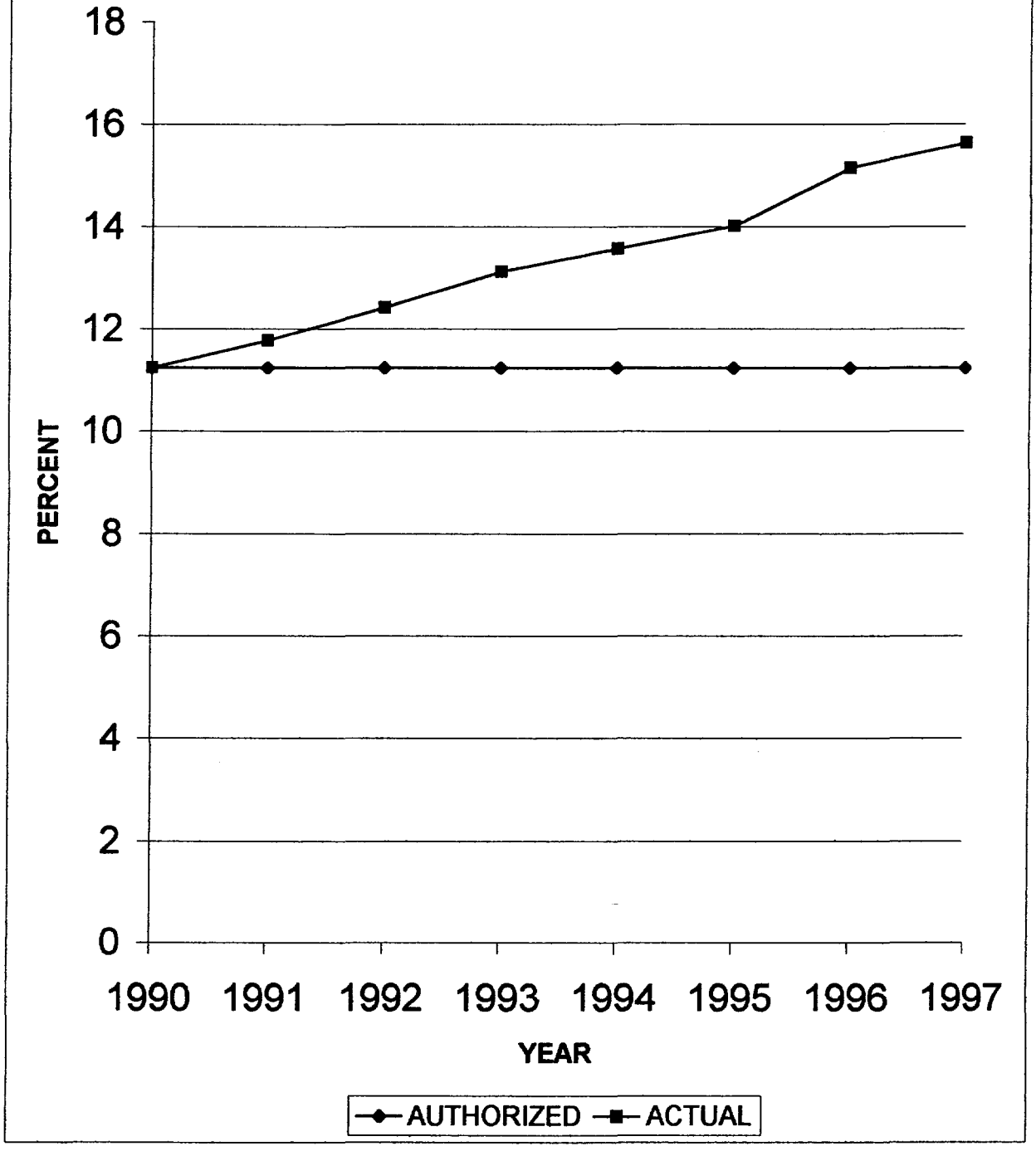
Claims that the incumbents face robust competition are entirely undercut by the performance of the market. If the market were competitive, we would expect to see a meaningful loss of market share, which has not happened. The incumbents could be preventing the loss of market share by lowering their prices. If that were the case, we would expect to see price discounting and shrinking profits. Neither of these is observed in the access market.

PROFITS

Above all, profits have been rising, not falling. Incumbents have consistently earned far more than the Commission established as its target rate of return. The excesses have been growing, not shrinking. Figure 1 shows the average rate of return achieved by the ILECs. As accounting costs based on figures filed with the Commission, there is no dispute over the calculation of these numbers. The rate of return increased by between 50 and 100 basis points (one-half and one percentage point) per year for the entire decade.

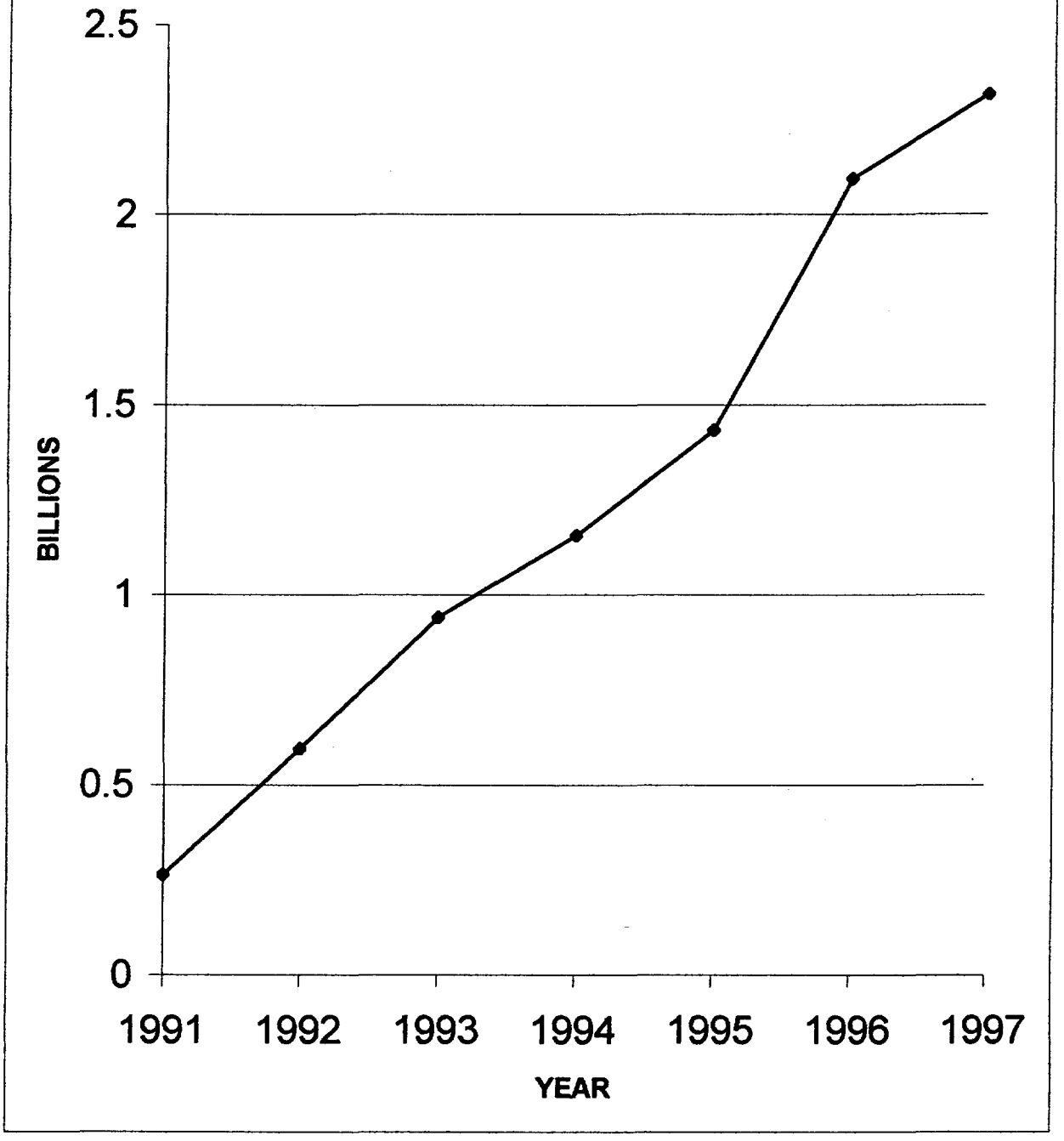
The dollar value of these excesses charges paid by consumers (including net income and taxes on that income) is huge (see Figure 2). Each year the excess charges increase by approximately half a billion dollars. The total excess builds over time to almost $2.5 billion in 1997. The cumulative total is over $8 billion.

FIGURE 1:
INTERSTATE RETURN ON INVESTMENT
ALL LOCAL EXCHANGE COMPANIES



Source: "Comments of ATT Corp. to Update and Refresh the Record," p. 23.

FIGURE 2:
CUMULATIVE OVERCHARGES FOR
ALL LOCAL EXCHANGE COMPANIES



Source: "MCI Worldcom Comments," p. 32, ROI set at 11.25.

PRICES

With market share losses from facilities-based competition virtually non-existent and profits rising, we would not expect to see any downward pressures on prices in the marketplace. The evidence presented to the Commission is that the LECs have not used the pricing flexibility it granted to them at all. They have no need to lower prices since there is no competitive threat.

Based on the prices identified in comments to the Commission, in Table 5 we estimate the impact of discounting in the exchange access market. The table shows that there is virtually no discounting.

TABLE 5:
THE ABSENCE OF PRICE COMPETITION IN
EXCHANGE ACCESS MARKETS
(MILLIONS OF $)

	TRUNKING	TRAFFIC SENSITIVE	COMMON LINE
TOTAL REVENUE	4539	8296	11118
REVENUE FOREGONE THROUGH DISCOUNTING	10	2	0
REVENUE AS A % OF CAP	99.78	99.98	

SOURCE: Discounting from "MCI Worldcom, Inc. Comments," In the Matter of Access Charge Reform Price Cap Performance Review For Local Exchange Carriers CC Docket Nos. 96-262, 94-1, RM-9201, October 26, 1998, p. 38; revenue from PRELIMINARY STATISTICS OF COMMON CARRIERS, Table 2.13. All revenue within a state is assumed to be discounted at the rate identified.

Prices are set at 99.8 percent of the caps. The incumbent prices are commensurate with their market shares. Clearly, the ILECs do not need additional pricing flexibility to

meet the competition since there is none and they have not used the flexibility they already have.

INCUMBENT ARUGMENTS

Since the incumbents cannot dispute the calculation of these numbers, they have chosen to claim that (1) accounting rates of return are irrelevant and (2) the purpose of price cap regulation is to give them the opportunity to earn excess profits. Both arguments are incorrect.

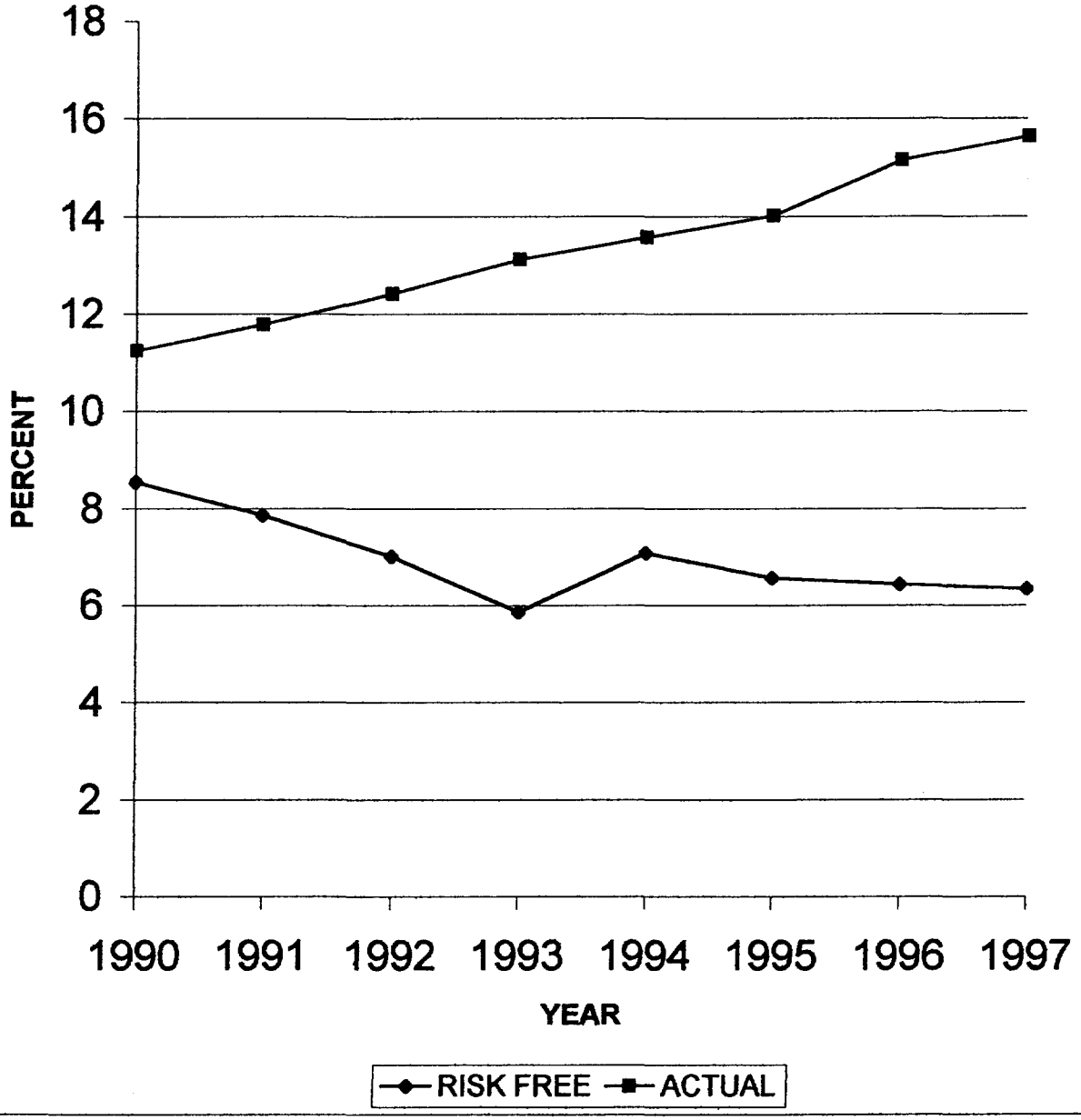
In adopting price cap regulation the Commission did not and could not abandon the requirement that rates be just and reasonable. It did not, nor could it, declare that the market was sufficiently competitive to ensure reasonable rates without regulatory oversight. Price caps must produce reasonable rates.

The fundamental measure of reasonable rates has always been and remains a rate of return that allows regulated companies an opportunity to earn a return commensurate with the risk it faces. Accounting rates of return have always been and remain the primary measure of that return. Prices that include unreasonably high rates of profit are unreasonable.

The risk premium embodied in the target rate of return was substantial and has been growing dramatically as the cost of capital has declined. That risk premium was not a gift to the companies. They were supposed to work hard to earn it.

Moreover, since the Commission established its target rate of return, the rate of inflation has declined dramatically as has the risk free rate of return (see Figure 3). The risk free rate of return has declined dramatically, by one quarter or 2 percentage points.

FIGURE 3:
RISK FREE RETURN ON INVESTMENT
LOCAL EXCHANGE COMPANY
ACHIEVED RISK PREMIUMS



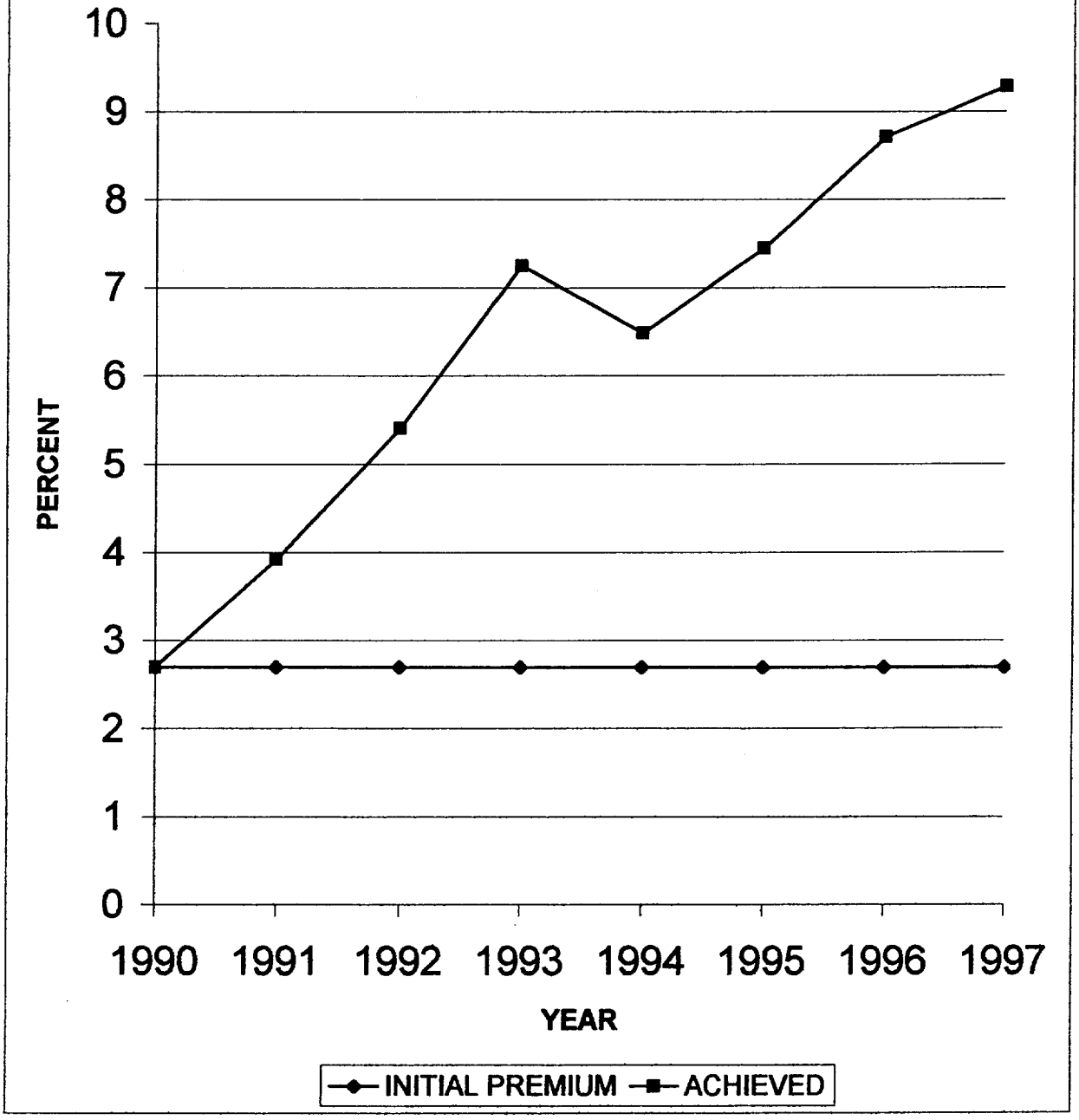
Source: ROI, Figure 1; Risk Free, ECONOMIC REPORT OF THE PRESIDENT: 1998, Table b-73, 10-Year Bonds

Failing to impose an adequate productivity factor or adjust the target rate of return to reflect the declining cost of money has distorted the stream of profits earned by incumbents. The result is not an incentive to be efficient; it is a huge windfall to the incumbents (see Figure 4). The risk premium earned in 1997 was over 3.5 times are large as the target premium set in 1990. The profits earned in excess of the target set by the Commission alone are over 1.5 times the risk premium set by the Commission.

The price cap LEC claim that any reduction in rates would destroy the "incentive" scheme of price caps confuses a legitimate incentive that rewards efficiency with a gift of a windfall that a lax productivity factor and declining cost of capital have given to the LECs. It ignores the fact that the LECs keep the billions of excess profits they have already pocketed. Price caps were not a blank check. They were an effort to balance greater incentives for efficiency with greater price reductiosn for consumers. The risk/reward scheme has become completely unbalanced. These profits are excessive and the rates that generate them can no longer be considered reasonable.

Adjusting the cost of capital in 1997 would add over $1 billion to the total overcharges. Thus, the total overcharges are about $3.5 billion. Eliminating these would be a major step toward cost-based pricing.

FIGURE 4:
INITIAL RISK PREMIUM COMPARED TO
LOCAL EXCHANGE COMPANY
ACHIEVED RISK PREMIUMS



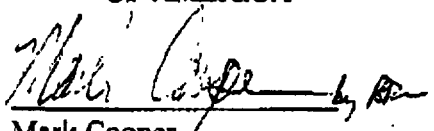
Source: Initial = 1990 authroized (Figure 1) minus 10-Year Bond (Figure 3);
Achieved = ROI (Figure 1) minus 10-Year Bond (Figure 3)

CONCLUSION

The evidence before the Commission makes it abundantly clear that prices charged for access are no longer just and reasonable and that the Commission cannot rely on competition to correct this problem any time soon. It must prescribe rates that lower access charges. The immediate step will be to increase the productivity factor, but that alone cannot solve the problem. Other elements of the access charge rate structure must be addressed, including reductions in FCC mandated line charges.

Respectfully submitted,

CONSUMER FEDERATION OF AMERICA



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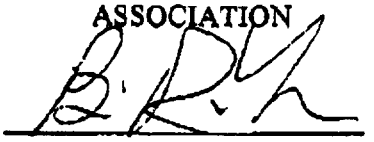

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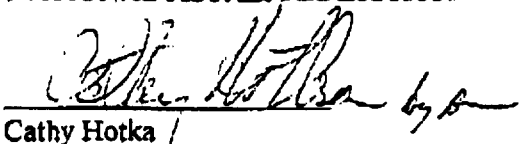

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November 9, 1998